

COMMISSION OF INQUIRY INTO THE  
FINANCES OF THE CITY OF YONKERS

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July 10, 2013

**REPORT ON THE "PRIDE" PROPOSAL OF THE YONKERS SCHOOL BOARD**

Introduction

The Commission Of Inquiry Into The Finances Of The City Of Yonkers was created by Mayor Mike Spano in March of 2012. It was initially asked to determine the size of City operating budget gaps, and to make recommendations for reform and improvement. It issued its' Report on April 23, 2012, which included recommendations such as requiring a four year Operating Budget projection, which was implemented by the Mayor later in 2012.

Early in 2013, the Yonkers Board of Education published a plan for construction of school facilities using a Public-Private-Partnership (P3) model, a first step in implementing a \$1.7 billion capital plan. The proposal is called PRIDE.

The Commission was asked by Mayor Spano to review the PRIDE Report and report to him as to whether it is cost-effective and would be of practical value to the people of the City.

The Commission did not inquire into the need for the Board's proposed \$1.7 billion dollar capital program, or the circumstances surrounding the drafting and adoption of the PRIDE Report. While our work did not extend to these issues we note that there is widespread agreement in the City that the schools are in a state of serious disrepair, that the need for new and upgraded facilities is considerable and that current levels of expenditure for new construction and operations and maintenance (O&M) are well below what is required.

The Commission takes no position on the general validity of P3 systems. The broad virtues and defects of P3 construction are widely debated, a discussion into

which we did not enter, and which is best left to policymakers in Federal, State and municipal governments.

In its public presentation of the Pride initiative, the Board compared the P3 plan to the conventional financing and construction model (CFC) now used by Yonkers and most school districts in New York. The PRIDE Report concluded that the P3 system provided net savings to Yonkers taxpayers of \$63.1 million. The Commission's analysis focuses on that comparison, and the assumptions and facts used to reach the PRIDE Report conclusions.

After receiving the PRIDE proposal the Commission did an initial review, which resulted in 13 questions being propounded to the Board by letter on April 8, 2013. The Board replied to each of those questions in a letter dated April 23, 2013. Both letters appear in Appendix A hereto.

### Summary Of Conclusions

The PRIDE Report is a long and complex document. It recommends adoption of the P3 model. The heart of that recommendation is a finding that the P3 option will generate savings to taxpayers of \$63.1 million (9.4%) over its' 35 year life span.<sup>1</sup>

The Commission focused its work in determining how the \$63.1 million in savings were calculated. As appears below, we find that both the methodology, the facts and the assumptions used to reach this conclusion are unreliable and replete with errors. These include arbitrary assertions unsupported by fact, and unsupported assumptions that are favorable to the P3 model.

We find that there are serious flaws in the Report that conservatively inflate the savings of the P3 proposal by over \$200 million. It follows from this conclusion that there is no rational basis for the assertion that the P3 model will generate \$63.1 million in savings. Rather, it is likely that the CFC model will be less expensive.

We re-emphasize that our conclusions are not directed at P3's in concept or for other specific P3 proposals. We examined the P3 proposal as it appears in the PRIDE Report and our conclusions apply to it alone. We recognize that there may be other virtues to a P3 system, including generating public support for an enhanced capital program for the schools, and attracting special support from other levels of government. We also recognize that the PRIDE Report can be viewed as a work in progress and that the Board may be able to clarify or change the facts and assumptions on which the Report relies. We urge the Board to examine this Report and provide explanation and clarifications. In that case, it

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<sup>1</sup> These estimates are a Net Present Value (NPV) of savings accrued over the lives of the P3 and the CFC systems.

would be prudent to revisit our conclusions. Unless and until that happens, we are confident that our financial analysis is accurate.

### Key Elements Of The PRIDE Report Upon Which Our Conclusions Are Based

The PRIDE Report asserts that the P3 alternative will save taxpayers \$63.1 million. There are six key assertions and assumptions on which the Report relies to reach that number and which we believe are not supported by fact or logic. These are:

#### 1) Payment of Taxes To The City of Yonkers.

The PRIDE Report asserts that a P3 model differs from a CFC model insofar as the private parties operating the P3 system will pay taxes to the Federal, State and City in the amount of \$44.6 million dollars. For the purposes of this analysis we accept the \$44.6 million estimate<sup>2</sup>. The Pride Report then assumes that the entire \$44.6 million is a direct revenue to the City of Yonkers. In other words, every penny of taxes paid to the United States Government and the State of New York is assumed to end up in the treasury of the City of Yonkers. There is no discussion of this assumption and the Board failed to respond to our April 8 question about it. It is highly unlikely that every penny of taxes paid by private parties working in Yonkers would return to the City. There is no precedent for nor evidence of such a system. The \$44.6 million in NPV taken in support of the P3 model should be removed.

#### 2) The Monetary Value Of Risk Adjustments

The PRIDE Report employs "Risk Adjustments" by which the value to taxpayers of the P3 alternative is increased by \$94.8 million, which itself changes the P3 model from to \$31.7 million more costly than the CFC model to \$63.1 million less costly. In other words, without these "Risk Adjustments" alone the P3 model would be more expensive than the CFC model. These "Risk Adjustments" are not real costs but estimates of potential costs (based on numerous long-term assumptions) that would be transferred to the private sector under the P3 model. Such savings may or may not be realized. The use of such conjectural savings to swing the P3 program from more costly to less costly is not prudent, however.

#### 3) The Monetary Value Of Delayed Payments

The PRIDE Report assumes that debt service payments for the CFC alternative begin in the first year and rise to full cost by second year; P3 payments do not

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<sup>2</sup> The PRIDE Report does not take into account complicated tax preferences available to private taxpayers that would likely reduce that amount. If further analysis is undertaken it should calculate those tax preferences.

start until three years later. Almost all of the NPV P3 savings can be attributed to this difference in payment scheduling over the first three years.

Projected NPV Savings	\$	%
Year 1 .....	\$ 8,631,369	13.7
Year 2 .....	24,921,612	39.5
Year 3 .....	26,545,813	42.1
Years 4 through 38 .....	2,990,406	4.7
<b>Total .....</b>	<b>\$ 63,089,200</b>	<b>100.0</b>

There are a variety of mechanisms available to the CFC model which could achieve similar savings. These include the use Bond Anticipation Notes (BANs) in the early years of the CFC program which are sold at lower interest rates than the long-term bonds that are eventually sold.

Such savings would cancel out most, if not all the savings in the PRIDE Report caused by the delay in payment schedules.

#### 4) The Monetary Value Of Increased O&M Efficiency

The PRIDE Report assumes that the Yonkers Public Schools are completely unable to improve its current system for O&M. It attributes \$39.7 million in increased efficiency to the P3 model and none for the CFC. This assumption is at best questionable. Even a partial improvement in management efficiency by the Board could result in savings of \$10M (25%). The PRIDE Report's projection of \$63.1 million in savings should be reduced by a reasonable amount resulting from improvements in Board efficiencies under a CFC system.

#### 5) The Monetary Value Of Operating Efficiencies

The PRIDE Report assumes operating efficiencies for the P3 of 10% for O&M and 5% for construction. These are asserted to be an estimated average savings based on empirical data from other Design-Build and P3 transactions in North America. There appears to be no data from school-type P3 projects in the PRIDE analysis. While this assumption does not have the same facial defects as the tax, scheduling and efficiency assumptions, it is simply not evidence-based. The 15 % savings (\$56.6M in nominal dollars) attributed to P3 by the PRIDE Report may be accurate or inaccurate. It is impossible to evaluate from the data in the Report and should not be included in the NPV calculation of \$63.1 million in savings.

#### 6) The Monetary Value Of Differing Inflation Assumptions

The PRIDE Report assumes a rate of inflation for the P3 alternative of 2.1%, and a rate of inflation for CFC of 3.1%, the historic average inflation increase over the

last 30 years. This 1% difference over 35 years produces significant savings for the P3 alternative, approximately \$36M. It appears that the PRIDE Report justifies this difference by relying solely on indices of labor costs. This assumption, again, is untested and cannot be relied on as an assured savings for the P3 model.

There are other serious issues raised in the PRIDE Report including the City's financial ability to make P3 availability payments for 35 years, the reasons that Lease/Purchase P3's were not actively considered, the growing uncertainty about nominal interest rates in the near and distant future, the spread between Treasury offerings and actual lending rates, the validity of a 13% assumed rate of return on private equity (The closest rate of return comparison is private equity. Median PE returns to pension funds are around 14%, while most marketing efforts assume rates in the high teens to low twenties per cent. If further analysis of the Pride proposal is done we suggest it include the effect of equity returns of 18-20 %.) and others. While we have examined these matters, they are complex and uncertain. The six areas of primary concern discussed above are so dispositive of the comparison of the financial risks and benefits of the P3 and CFC alternatives however that we leave further analysis of these other issues for a subsequent effort.